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SUBJECT: GOI ON EU/USG IMPASSE ON IDA GRANTS NEAR
IMPOSSIBLE TO OVERCOME

CLASSIFIED BY: ECONOMIC MINISTER COUNSELOR MARGARET DEAN FOR REASONS 1.
5 (B).

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1. (C) SUMMARY. THE EU'S POSITION ON AN ENHANCED IDA GRANT PROGRAM IS CLEAR: SUCH A PROGRAM MUST BE VERY LIMITED IN SCOPE, TARGETED FOR BASIC NEEDS (E.G. HEALTH AND EDUCATION), AND TESTED OVER SEVERAL YEARS. LORENZO BINI SMAGHI, DIRECTOR GENERAL FOR INTERNATIONAL FINANCIAL RELATIONS AT ITALY'S FINANCE MINISTRY, TOLD EMIN THAT THE DIVERGENT VIEWS BETWEEN THE U.S. AND EUROPE MAY NOT BE RECONCILABLE. FURTHER U.S. INSISTENCE MAY PROMPT SOME MEMBER STATES TO RETRACT THEIR SUPPORT FOR A BEEFED UP GRANT PROGRAM, AT ANY LEVEL, HE WARNED. END SUMMARY.

2. (C) POST MET WITH BINI SMAGHI, ITALY'S FINANCIAL SHERPA, WHO OVERSEES ALL INTERNATIONAL FINANCIAL POLICY, TO DISCUSS IDA AND OTHER FINANCIAL ISSUES. TREASURY U/S TAYLOR AND HE HAVE BEEN IN FREQUENT CONTACT ON IDA GRANTS AND OTHER ISSUES. BINI SMAGHI SAID THE EU, WHICH CONTRIBUTES NEARLY 50 PERCENT TO IDA, HAS MET THE UNITED STATES PART WAY ON THE ISSUE OF IDA GRANTS. THERE IS NO WAY THE U.S.- DESIRED TARGET LEVELS FOR IDA GRANTS CAN BE REACHED IN SUCH A SHORT TIME, BINI SMAGHI ARGUED. NO CERTAINTY EXISTS THAT AN ENHANCED PROGRAM, AT THE LEVELS IDENTIFIED BY THE USG, WOULD BE EFFECTIVE, ESPECIALLY IN THE ABSENCE OF STRONG, WELL-DEFINED AND ENFORCED CONDITIONALITY. PREVIOUS LENDING POLICIES SHOULD NOT BE ABANDONED OVERNIGHT, HE CONTENDED.

3. (C) THE EU'S POSITION HAS NOT BEEN STATIC. "WE ARE NOW WILLING TO CONSIDER FOR CERTAIN GROUPS OF COUNTRIES -- PERHAPS FOR THOSE WITH A PER CAPITA OF US ONE DOLLAR A DAY OR LESS -- A GRANT PROGRAM OF 50 PERCENT, TARGETED FOR HEALTH AND EDUCATION. IN POST-CONFLICT AND NATURAL DISASTER CASES, A GRANT PROGRAM OF 100 PERCENT COULD EVEN BE CONSIDERED,"

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STATED BINI SMAGHI. THIS SHOULD BE THE FRAMEWORK FOR AN ENHANCED IDA GRANT PROGRAM. IF THE PROGRAM IS SUCCESSFUL, BY MEASURES STILL TO BE DEFINED, THE LEVEL OF GRANTS COULD BE INCREASED AT A FUTURE DATE, TO MIRROR THE LEVELS THE USG NOW PROPOSES. BINI SMAGHI BELIEVES A MINIMUM OF THREE YEARS IS REQUIRED TO TEST THE EFFECTIVENESS OF A RECONSTITUTED GRANT PROGRAM.

4. (C) RATHER THAN INSISTING ON GREATER MOVEMENT BY EUROPEAN GOVERNMENTS, THE USG SHOULD RECOGNIZE AND ACCEPT THE PROGRESS MADE WITH EU MEMBER STATES. THE USG SHOULD NOT IGNORE THE CONTENTIOUSNESS OF THIS ISSUE, AND THE SERIOUS OPPOSITION FROM SEVERAL COUNTRIES, ESPECIALLY IN SCANDINAVIA, TO ANY INCREASE IN GRANTS, BINI SMAGHI COMMENTED. THE USG'S RELENTLESS PRESSURE ALMOST CAUSED NORWAY, SWEDEN AND A FEW OTHERS TO RETRACT THEIR SUPPORT FOR EVEN A LIMITED, TARGETED 50 PERCENT GRANT PROGRAM. BINI SMAGHI ASSERTED THAT IT WAS ONLY BECAUSE ITALY, AS A G7 MEMBER, EXERTED PRESSURE ON SEVERAL GOVERNMENTS THAT EU CONSENSUS KEPT FROM BREAKING DOWN.

5. (C) THERE'S A PERCEPTION AMONG EU MEMBERS THAT THE USG DOES NOT UNDERSTAND THEIR ASSISTANCE PROGRAMS, BINI SMAGHI REMARKED. GRANTS ARE THE PREFERRED MECHANISM FOR BILATERAL ASSISTANCE PROGRAMS, AND EU GOVERNMENT CONTRIBUTIONS TO THE UNDP. "SO, CLEARLY, WE ARE NOT OPPOSED TO GRANTS IN PRINCIPLE," HE ARGUED. FOR EU GOVERNMENTS, HOWEVER, IT IS IMPORTANT TO MAINTAIN THE APPROPRIATE DIVISION OF LABOR BETWEEN THE WORLD BANK AND THE UNITED NATIONS, BETWEEN THE INTERNATIONAL FINANCIAL INSTITUTIONS AND BILATERAL ASSISTANCE PROGRAMS. MOREOVER, THE WORLD BANK DOES NOT HAVE THE

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NECESSARY EXPERTISE TO ESTABLISH AND MONITOR THE IMPOSITION OF EFFECTIVE CONDITIONALITY. (NOTE: MOST OF ITALY'S BILATERAL ASSISTANCE ALSO IS IN GRANT FORM. ITALY HAS, HOWEVER, A LOW LEVEL OF OFFICIAL DEVELOPMENT ASSISTANCE, JUST .14 PERCENT OF GDP IN 2001. THE GOI HAS MADE SOME NOISE ABOUT UPPING THIS TO .7 PERCENT OF GDP BY 2006, BUT NO ROAD MAP TO THAT TARGET YET EXISTS. END NOTE.)

16. (C) COMMENT: BINI SMAGHI IS CLEARLY PESSIMISTIC THAT THE IMPASSE BETWEEN THE USG AND THE EU WILL BE BROKEN IF WE CONTINUE HARD OVER ON OUR WAY. HE WAS WILLING TO HEAR OUR ARGUMENTS, BUT DID NOT DEVIATE FROM THE EU COMMON POSITION. ITALY WHOLEHEARTEDLY SHARES THE EU CONSENSUS AND A PHASED APPROACH TO INCREASING THE PROPORTION OF GRANTS. THEY WILL USE THEIR INFLUENCE, AS THEY HAVE ALREADY DEMONSTRATED, TO KEEP THE EU CONSENSUS AT 50 PERCENT, WITH CONDITIONS FOR CERTAIN COUNTRIES. THEY HAVE NO INTEREST IN BROKERING ANYTHING BEYOND THIS. END COMMENT.

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